



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

On the record with the treasurer

With the legislative session in full force, the state's top elected financial officer weighs in on the major issues.

On the American Indian Cultural Center and Museum (AICCM)

Three camps have developed on the AICCM: those staunchly in favor, those adamantly opposed and those in the middle who have become frustrated dealing with this longtime, problematic project. I understand the sentiments of those frustrated with the inefficiency and waste incurred by the state's poor planning and implementation. I can even understand the sentiments of those who think the project should not have been started in the first place. But today is

today and a financial – not political – decision needs to be made. The AICCM needs to be completed, and the Senate's debt-free proposal is the most viable yet.

This is a perfect example of microeconomic decision-making theory where sunk costs, those which have already been incurred, are considered irrelevant to a rational investment decision. Tens of millions have been sunk into the project and cannot be recovered, yet it is costing nearly \$6 million per year in interest and maintenance expenses and is unable to generate income in its present condition.

Since sunk costs are irrelevant, the decision today centers on spending \$40 million to get \$40 million and complete the project so it can generate revenue and mitigate costs. The theory fails to hold when human nature allows sunk costs and personal consequences to bias decision makers.

On Unclaimed Property funds

As trustee of the Unclaimed Property (UP) Fund, the treasurer is statutorily charged with determining the amount the Legislature can use for a public purpose. This provision is an important consumer protection, but has been forgotten in the past.

UP funds were never intended to be a major recurring revenue source, but about \$10 million has been built into the annual revenue certification since inception. Additional UP dollars have

been used to mitigate deep cuts to core services during times of extreme fiscal distress. Unfortunately, this practice has continued even though the economy has recovered. UP funds may be appropriately tapped during recessions, but a habitual dependence on them during expansion is quite different.

Habits can be good or bad. Here are three reasons why this one is bad:

1. The money does not belong to the state.
2. The amount of money coming into the unclaimed property fund varies greatly – in the last 10 years it has ranged from \$18.4 million to \$61.4 million; so, if it is built into the budget one year it may not be there the next.
3. Great strides have been made in returning unclaimed property to its rightful owners – on pace this year to nearly double last year's record amount – meaning fewer excess dollars will be available to the Legislature in future years.

Hopefully, legislators will not want to impede the program's progress to facilitate state spending.

On Capitol repair bonds

Last year's bill to fund restoration of the State Capitol was a good faith effort. Unfortunately, such a strategy could not work this year due to budget problems. That leaves a bond issue as the only viable alternative.

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Treasurer's Commentary

By Ken Miller, Ph.D.

It's a strange, strange world

I was recently asked by a business faculty colleague at our annual school year-end luncheon how I was enjoying public service. I joked that after having served time in the Legislature, being “paroled” to the treasury felt much like a normal finance job. His reply “Well, it might be more normal than being in the Legislature, but it is certainly not a normal job,” was followed with a chorus of laughter from the table.

I think my friends at Oklahoma Christian University see me as a fairly regular guy, but like many Oklahomans, they see the world of politics as very strange - and rightly so. One need only look at a few of this session's fiscal issues to understand the sentiment.

The session started out with a House Speaker against bonds, but for the American Indian Cultural Center and Museum. A few weeks later, a new Speaker emerged who was seemingly for bonds but against funding the AICCM, at least as indicated by the 51-Republican majority requirement he levied on the AICCM but not the Capitol bonds bill.

After sailing through the Senate, the bond bill went down 34-62 on the House floor with even those voting against stating that something must be done to restore our state's

crumbling symbol of democracy - just not debt. This seems peculiar given Oklahoma has one of the nation's lowest debt-to-GDP ratios, there is insufficient revenue to pay-as-you-go, inflationary cost attached to a piecemeal approach would outweigh interest expense, and the Rainy Day Fund is for unexpected emergencies not self-imposed ones. Odder still when some in our state point to Kansas as the model of fiscal conservatism and our northern neighbor just restored its state capitol using a \$300 million bond issue.

“Without creativity, the Legislature can't balance its budget with the tax and spending structure it has today - even during an economic expansion.”

It's even a bit funny considering many of those who bemoan all debt have a mortgage and believe government should be run like a business - where debt is the most often used tool for investment.



One might think a consistent anti-debt sentiment would exist for completion of the AICCM, but for this capital project, neither bonds nor cash yet appear viable. Though the bill authorizing \$40 million in Unclaimed Property money easily passed the Senate and reportedly had sufficient votes for passage in the House, it failed to get a hearing in the latter by falling short of the Speaker's 51-Republican threshold.

Other than a few outliers who suggested cutting losses with a bulldozer, most opponents expressed support for completion of the center. Some suggested the tribes or Oklahoma City should pay the remaining costs. This seems odd since the AICCM is a *state* entity created by the Legislature, which in its present condition is unable to generate income but costs \$5.2 million per year in debt service to retire \$63 million in bonds for the next 13 years and \$624,000 annually

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Commentary

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in mothball expenses. Perhaps not so odd is the desire for someone else to take responsibility for the state's bad planning, execution and sunk costs attached to this 20-year project.

Others suggested it is just bad timing for the state to use \$40 million from Unclaimed Property to finish the AICCM due to the \$188 million budget shortfall. They suggest this money should instead be used to fund

government services. Strange, since UP funds were never intended to be a recurring state revenue stream. It is other people's money – previously hard-earned – and using it would create a budget hole in subsequent years. Stranger still, because gross state revenue collections are up more than ever, but General Revenue Fund allocations are down due to increased use of off-the-top earmarks. And perhaps strangest of all, the Legislature just passed a \$200 million per year income tax cut and a \$600 million off-the-top education

spending increase when, without creativity, it can't balance its budget with the tax and spending structure it has today – even during an economic expansion. Yes, there might be a timing problem alright, just not the one suggested.

All of this oddness, without even introducing the more controversial social or education issues. I'm sure in some parallel universe this would all make sense, but to the regular folks on this planet it seems very strange indeed.

On the record

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Politically, bonds may be difficult for some to support. Financially, bonding the Capitol restoration is a no-brainer. Oklahoma has one of the nation's lowest debt-to-GDP ratios at 1.5 percent, half the 50-state average. There is insufficient revenue to pay as you go and likely will be for the foreseeable future. The inflationary cost of a piecemeal approach outweighs interest expense. And the Rainy Day Fund should be reserved for unexpected emergencies, not self-imposed ones.

Oklahoma's debt service is currently well below the new statutory debt cap of five percent of GRF, and even with the Capitol bond issuance, the state's annual debt service would remain around \$89 million below the debt limit. Since most legislators agree Capitol repairs are necessary, and the expense falls within their own debt limit, there should be no conflict.

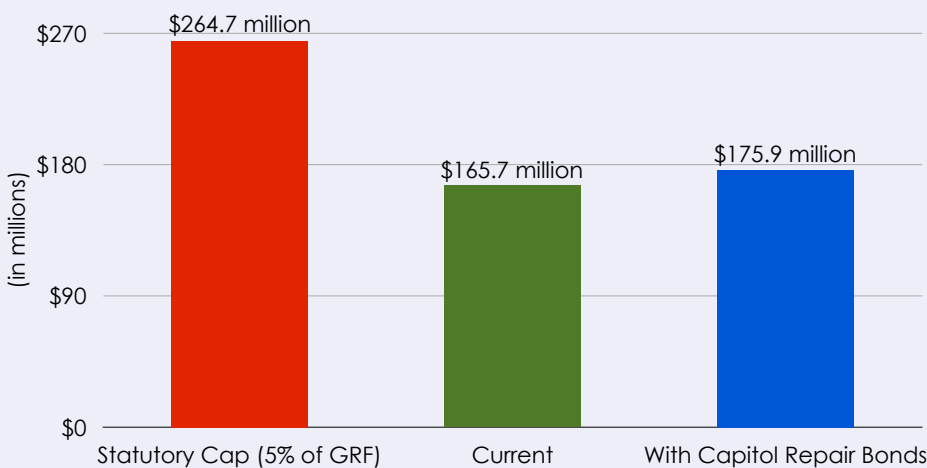
On pension reform

With \$11.3 billion in unfunded liabilities, Oklahoma's pension debt

is the largest obligation on the state's balance sheet. Yet, for all the talk about

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Oklahoma's Conservative Debt Limit Annual Debt Service



Law enacted in 2013 limits annual debt service to five percent of a rolling five-year average of General Revenue Fund collections. Current debt service is 63 percent of the limit. A \$160 million bond issue to repair the State Capitol would raise debt service by only three percent of the cap.

Source: State Bond Advisor



On the record

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pension reform, the effort to move Oklahoma away from an expensive and outdated pension system is still not complete – and to date, not even started for OTRS, our state’s \$8 billion debt problem.

It’s encouraging to see House and Senate leadership and their pension chiefs pass legislation that would move new hires under the state’s second-largest pension system, OPERS, to a 401(k)-style benefit plan, although both measures still languish in conference. The state is unlikely to afford better salaries on the front end unless it reduces pension costs on the back end.

It’s discouraging to hear reports that the House chair communicated his refusal to even consider a common-sense bill introduced this year in the Senate to streamline the administration of the state’s two largest plans. While most are quick to rail against government waste

and inefficiency, efforts to eliminate it are routinely dismissed because of political difficulties.

On the tax cut

Oklahoma should not focus solely on lowering the income tax but rather on reforming our entire outdated tax structure, which was built for an economy that no longer exists. Generally speaking, the ideal tax structure would generate a stable and diversified revenue stream while retaining the profit motive that drives entrepreneurship and not unfairly burden property owners, discourage consumption or reward idleness.

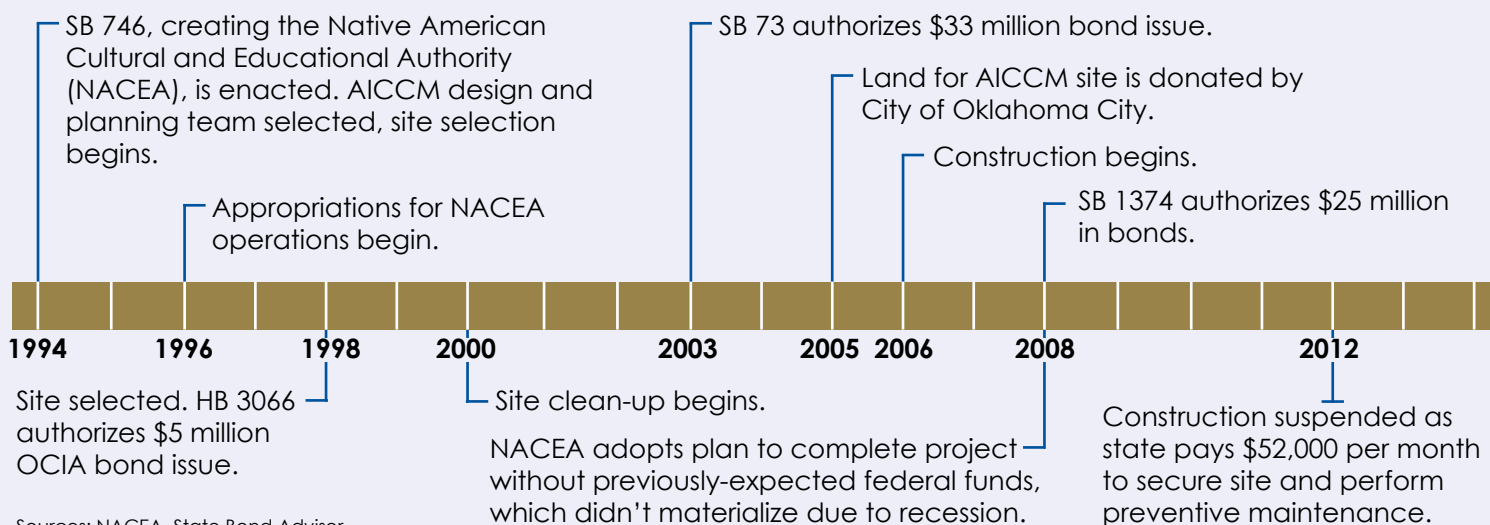
Recent discussions regarding tax reductions have been much more responsible than just a few years ago. Specific to the recently-signed bill, the state will be able to manage implementation because of the revenue growth triggers. That being said, I have never understood the logic of triggers

since there is no economic reason to pass a measure today that is predicated on some future event, when one can simply wait for that event to occur to preserve flexibility. However, if passing a tax cut during a budget shortfall is unavoidable then the use of triggers is better than not.

I also would like to see our income tax under five percent, but one must consider the timing of passing a \$200 million per year income tax cut when the state is unable to balance its budget with the tax and spending structure it has today - even in an economic expansion - without using ever-increasing amounts of one-time sources of revenue.

Even if such a marginal change in tax policy generates increased revenues, it would take time. So, policymakers will have to get ready for some very tough decisions going forward. Real opportunities for better budget prioritization still exist, but they will be hard fought.

American Indian Cultural Center and Museum (AICCM) Timeline





Revenue failure possible during FY-14 final quarter

With General Revenue Fund (GRF) allocations running more than five percent below the estimate for Fiscal Year 2014, state officials are warning a revenue failure might occur before year end on June 30.

Three quarters into FY-14, allocations to the GRF total \$3.9 billion and are short of estimated collections by \$215.4 million or 5.2 percent, according to the Office of Management and Enterprise Services.

Agencies warned

The announcement prompted Preston Doerflinger, Secretary of Finance, Administration and Information Technology, to warn state agencies that unless the picture improves across-the-board cuts might become necessary.

According to the state constitution, such action, known as revenue failure, is required when tax collections are insufficient to fully fund appropriations during a fiscal year.

The Legislature is authorized to appropriate no more than 95 percent of the official estimate to allow for up to a 5 percent downward variance in GRF allocations without triggering cuts.

In an email to agency directors on April 15, Doerflinger said if revenue failure occurs, “allocation reductions to agencies would likely be less than 1.5 percent.”

Shrinking corporate collections

Of the major revenue streams, corporate income tax collections are off the estimate by the largest percentage and

dollar amount.

Corporate allocations are below the estimate by \$112.79 million or 36.6 percent.

Sales tax allocations are below the estimate by the second largest dollar amount, at \$62.4

million or 4.1 percent lower than the estimate.

Other sources, a combination of several dozen smaller sources of revenue, are below the estimate by \$61.1 million or 11 percent.

The three other major revenue streams are performing ahead of estimated allocations.

Gross production allocations are higher than the estimate by \$11 million or 5.8 percent. Motor vehicle collections are beating the estimate by \$5.5 million or 3.4 percent. Personal income tax allocations exceed the estimate by \$4.47 million or 0.3 percent.

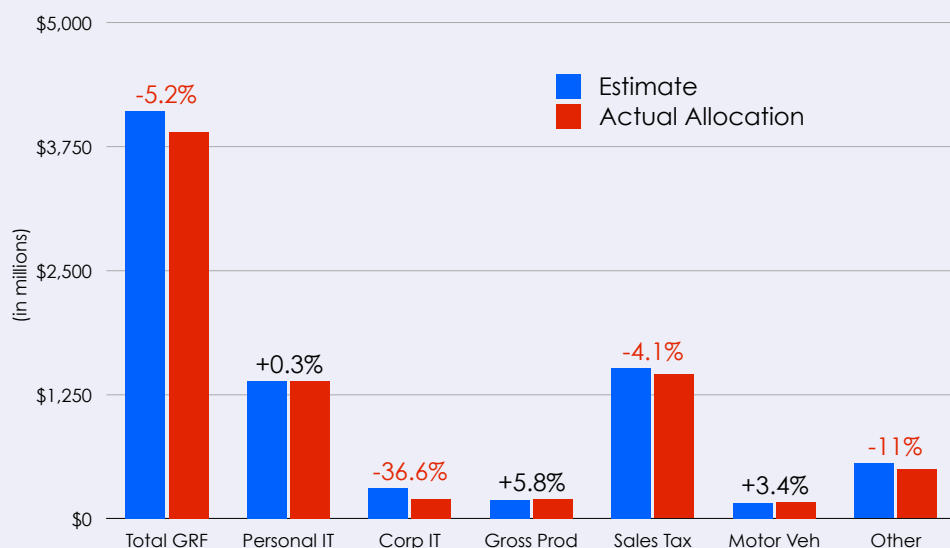
More cuts coming

The softening GRF allocations come as the Legislature negotiates a smaller FY-15 budget with the administration.

The State Board of Equalization’s final estimate for next fiscal year is more than \$188 million lower than the FY-14 estimate.

“Unless the picture improves, across-the-board cuts might become necessary.”

General Revenue Fund Comparison to Estimate
Through 3rd Quarter, Fiscal Year 2014



Source: OMES



Gross receipts & General Revenue compared

The Treasurer's April 3 gross receipts to the treasury report and the Office of Management and Enterprise Services' April 15 General Revenue Fund (GRF) report contain several differences.

March gross receipts totaled \$985.02 million, while the GRF received \$412.8 million or 41.9% of the total.

The GRF received between 33.1% and 57.1% of monthly gross receipts during the past 12 months.

From March gross receipts, the GRF received:

- Personal income tax: 30.1%
- Corporate income tax: 60%
- Sales tax: 44.7%
- Gross production-Gas: 23.3%
- Gross production-Oil: 69.1%
- Motor vehicle tax: 25%
- Other sources: 49.3%

March GRF allocations missed the estimate by \$41.4 million or 9.1%. Fiscal year-to-date allocations are below the estimate by \$215.4 million or 5.2%.

For March, insurance premium taxes totaled \$17.83 million.

Tribal gaming fees generated \$9.79 million during the month.

Positive momentum continues in state economy

Energy production, personal income and consumption pushed revenue collections higher in March, State Treasurer Ken Miller announced today as he released the monthly Gross Receipts to the Treasury Report.

Miller said collections in March grew by more than four percent over the same month of last year. The growth rate for the past 12 months also topped four percent.

“Oklahoma’s economy continues to do relatively well.”

than five percent,” he said. “Oklahoma’s economy continues to do relatively well.”

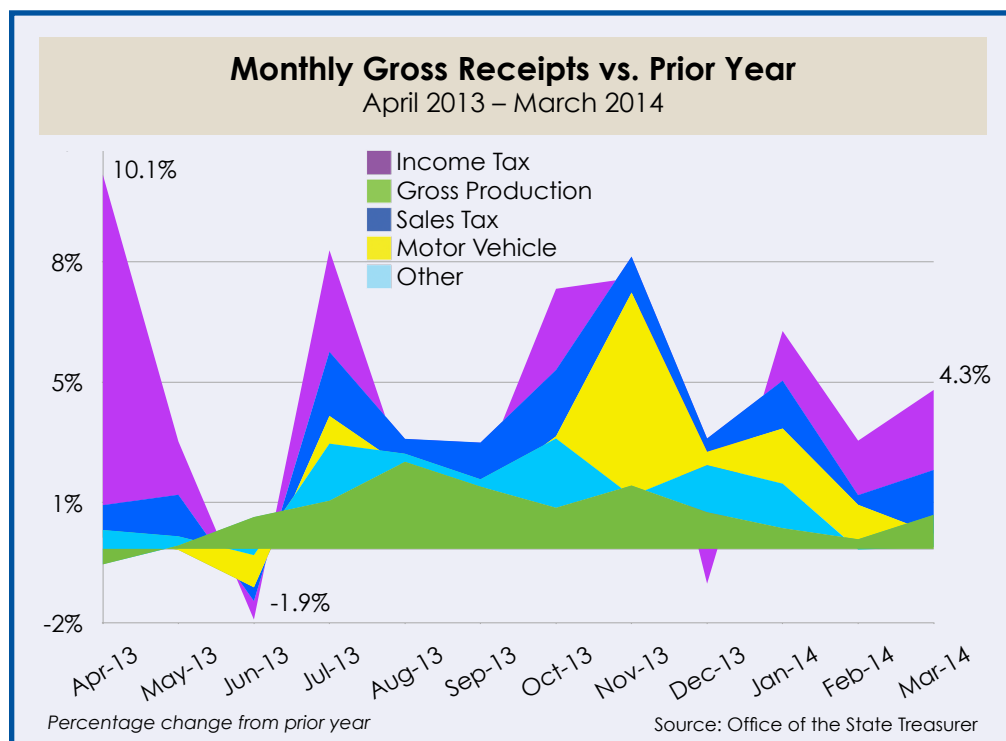
Total monthly collections have exceeded the prior year 10 times in the past year, with oil and gas production taxes up for 11 consecutive months.

The March report shows only one major revenue stream with

collections lower than last March – corporate income tax, which has dipped

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State unemployment hits five-year low in March

Oklahoma's seasonally-adjusted unemployment rate was listed at 4.9 percent in March by the Oklahoma Employment Security Commission, the first time the rate fell below 5 percent since December 2008.

During the month, statewide employment increased by 160 jobs, while unemployment dropped by 1,540 people according to the preliminary, seasonally-adjusted figures. Over the year, unemployment decreased by 5,200 people.

The national unemployment rate was set at 6.7 percent in March.

State Unemployment Report				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Mar '14	4.9%	1,823,760	1,734,360	89,400
Feb '14	5.0%	1,825,140	1,734,200	90,940
Jan '14	5.2%	1,824,560	1,730,470	94,090
Dec '13	5.4%	1,823,410	1,724,920	98,480
Nov '13	5.5%	1,822,060	1,722,590	99,480
Oct '13	5.6%	1,821,950	1,720,460	101,480
Mar '13	5.2%	1,811,590	1,716,580	95,020

* Data adjusted for seasonal factors

Source: OESC

Revenue

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below the prior year in seven of the past 12 months.

Positive data

Miller said the state's personal income, recently released by the U.S. Bureau of Economic Analysis (BEA), sheds

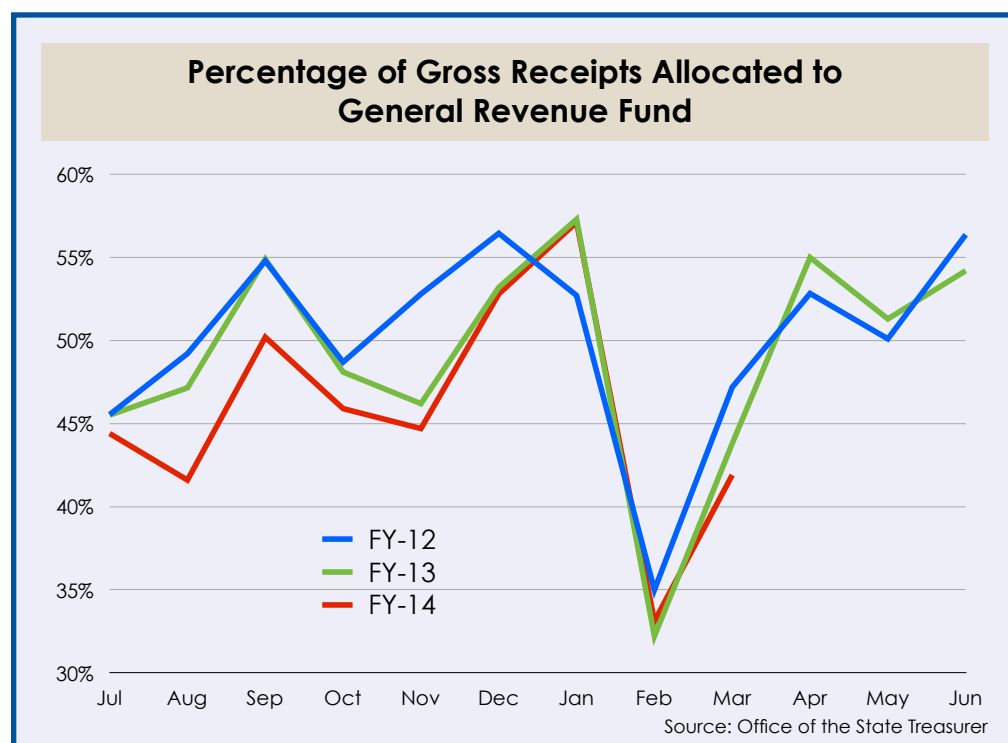
a positive light on the Oklahoma economy.

"Last year, Oklahoma's total personal income grew faster than the national average, as it has done in each of the four years since the Great Recession," he said. "Total personal income was up 3.3 percent in 2013 at \$160.1 billion, the seventh-highest growth rate in the nation."

About Gross Receipts to the Treasury

Since March 2011, the Treasurer's Office has issued the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state's macro economy.

As announced by Governor Mary Fallin, it is released in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

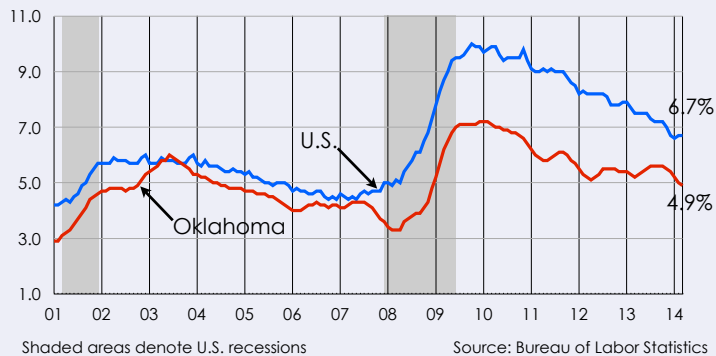




Economic Indicators

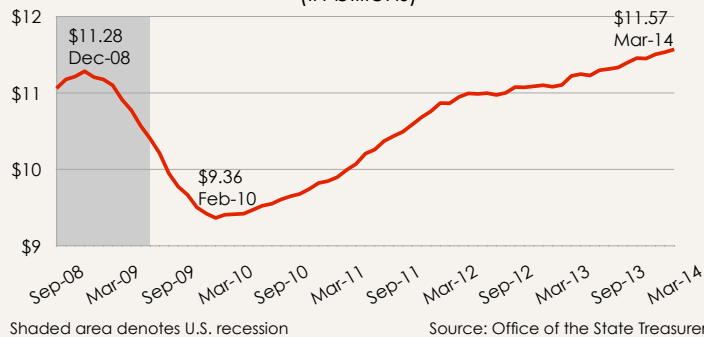
Unemployment Rate

January 2001 – March 2014

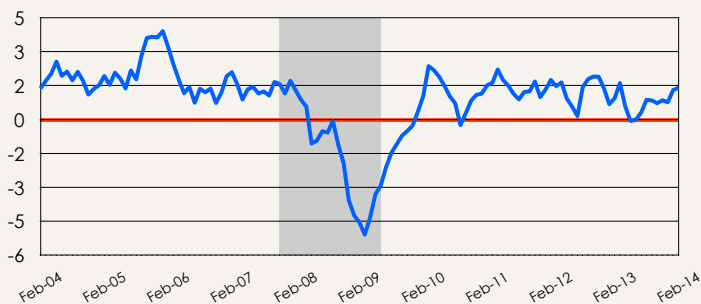


Oklahoma 12-Month Gross Receipts

September 2008 - March 2014
(in billions)



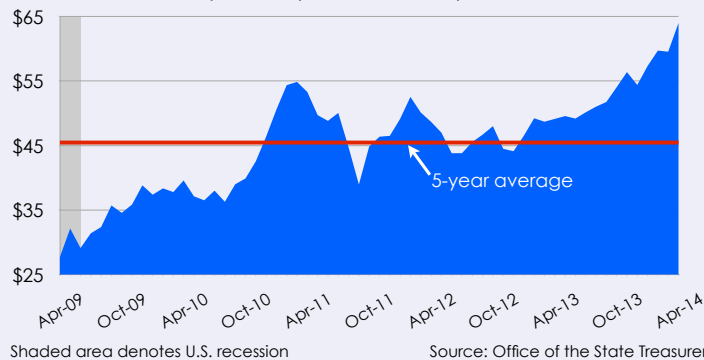
Leading Index for Oklahoma



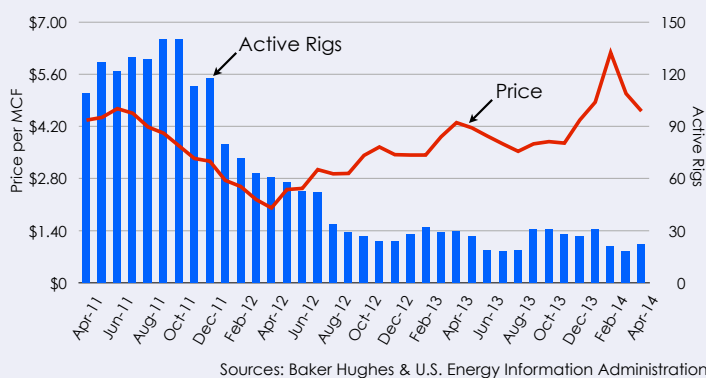
This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings.

Oklahoma Stock Index

Top 25 capitalized companies



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

